No. 87-1521

In the Supreme Court of the United States

OCTOBER TERM, 1987

DANIEL J. MAHONEY, JR., EXECUTOR OF THE ESTATE OF JAMES M. COX, JR., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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TABLE OF AUTHORITIES

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Petitioner contends that the decedent's transfer of property to a trust in which he retained a life interest was "a bona fide sale for an adequate and full consideration" within the meaning of Section 2036(a) of the Internal Revenue Code,[1] thereby exempting the property from inclusion in the decedent's gross estate for federal estate tax purposes.

1. In 1941, the decedent's father established a trust and funded it with 750 shares of the common stock of the Atlanta Journal Company. The trust instrument named the decedent as life beneficiary and his wife and children as remaindermen. Concurrently, the decedent executed a promissory note to his father, which recited that it was in payment for 750 shares of common stock of the Atlanta

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

Journal Company. The promissory note was in the amount of $4,666.88, the equivalent of $6.2225 for each of the 750 shares, which had been their basis in the hands of the father. Thereafter, the Commissioner asserted that the stock was worth at least $200 per share at the time it was transferred to the trust, and that the father therefore owed gift tax on the transfer. The gift tax dispute was compromised in 1952, the father and the Commissioner agreeing that the fair market value of the stock at the time of the transfer was $55 per share, or a total of $41,250 for 750 shares. The father thereafter reported and paid gift tax on a gift of $36,583, reflecting the agreed value of the stock in 1941 ($41,250) less the consideration ($4,666.88) that the decedent paid for the stock. Thus, in light of the compromise, the amount paid by the decedent equalled 11.3136% of the 1941 fair market value of the stock, the equivalent of 85 of the 750 shares; the remaining 88.6864%, or 665 shares, represented his father's gift to the trust. Pet. App. 2a-4a, 21a-22a.

The decedent died in 1974. On the estate tax return, no part of the trust property was included in the gross estate for federal estate tax purposes. On audit, the Commissioner reasoned that the decedent had provided consideration for 85 of the shares that had been conveyed to the trust in 1941 and thus in substance had "made a transfer" to the trust of those shares, reserving a life interest therein. Accordingly, the Commissioner concluded that the date-of-death value of those 85 shares (*i.e.*, 11.3136% of the total value of the trust property), which was $5.5 million, must be included in the decedent's gross estate under Section 2036(a) of the Code,[2] and the Commissioner asserted

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[2] Section 2036(a) provides in pertinent part:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has

an estate tax deficiency on that basis. Petitioner paid the deficiency and then filed an administrative claim for refund, which was denied. He then brought this refund action in the United States District Court for the Southern District of Ohio, contending that Section 2036(a) was inapplicable on the theory that the decedent had not "made a transfer" to the trust within the meaning of that provision, but rather that any transfer had been made by his father. Pet. App. 3a-4a.

2. a. The district court ruled in favor of petitioner (Pet. App. 17a-36a; 628 F. Supp. 273). The court observed that "the only question" was whether the funding of the trust involved a "transfer" by the decedent for purposes of Section 2036(a) (Pet. App. 27a). Using the valuation assigned to the stock in the 1952 gift tax settlement, the court found that the conveyance of stock to the trust by the decedent's father was "in part a sale (11 + percent of the value of the stock)" and "in part a gift (88 + percent of the value of the stock)" (*ibid.;* see also *id.* at 18a-24a). The court also found that the decedent had furnished the consideration for the portion of the transaction that was a sale (*id.* at 27a-30a). The court found, however, that the decedent had purchased from his father only a life estate in the stock, rather than an interest in fee. Since the decedent therefore had no remainder interest to convey and he retained the right to the income from the stock even after it was transferred to the trust, the court concluded that he

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at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property * * *.

had not "made a transfer" of an interest in property that would bring Section 2036(a) into play. Pet. App. 29a-35a.

b. The court of appeals reversed (Pet. App. 1a-16a; 831 F.2d 641). Like the district court, the court of appeals noted "[t]he only issue" was whether the decedent had "made a transfer" within the contemplation of the statute (Pet. App. 9a). The court of appeals agreed with the trial court's finding that, in light of the 1952 settlement, the decedent's father had conveyed a portion of the stock to the trust as a sale, and had conveyed the other portion to the trust as a "taxable gift" (*id.* at 3a-4a & n.3). Unlike the district court, however, the court of appeals deemed the decedent to be "the effective grantor of the Trust" to the extent of the consideration he paid, reasoning that the economic effect of the transactions was the same as if the decedent had purchased 85 shares of stock from his father and then had conveyed them to the trust himself (*id.* at 13a-16a). Rejecting the district court's "revisionist assertion that the decedent purchased only a life estate in the Trust corpus," the court of appeals found that "[n]othing in the form or execution of the transaction suggests that the parties intended that decedent's consideration was in payment for anything less than the total 'bundle' of rights inherent in owning property" (*id.* at 13a).

The court of appeals further explained that it "ha[d] no difficulty" in characterizing the transactions as " 'essentially testamentary,' " because the named remaindermen of the trust were the decedent's wife and children, "the natural objects of his bounty" (Pet. App. 14a, quoting *United States* v. *Estate of Grace*, 395 U.S. 316, 320 (1969)). The court then observed that the revaluation of the trust property in the gift tax dispute did not change the " 'nature and operative effect of the transfer,' " although it did change the percentage of the trust that is includable in the gross estate (Pet. App. 14a). The court held that,

because the $4,666.88 paid by the decedent represented 11.3136% of the stock as revalued, "the same portion of the date-of-death value of the Trust must be included in decedent's gross estate under Section 2036(a)" (*id.* at 14a-15a (footnote omitted)).

c. On December 30, 1987, 75 days after the court of appeals' decision, petitioner moved the court to modify its opinion and mandate. He did not contest the court's holding that the decedent had "made a transfer" of stock to the trust. Instead, petitioner raised a new claim not previously made in the court of appeals, namely, that the decedent's "transfer" to the trust was excepted from the reach of Section 2036(a) as "a bona fide sale for an adequate and full consideration in money or money's worth." Petitioner urged that this question should be considered in the first instance by the district court on remand. To that end, he requested the court of appeals to change its mandate from "reversed" to "reversed and remanded for further proceedings" and to add the following sentence to its opinion: "We express no opinion on whether the transfer falls within the scope of the bona fide sale exception to Section 2036(a)" (Motion to Modify Opinion and Mandate 9-11). The court of appeals denied the motion (Pet. App. 37a).

3. Petitioner does not challenge in this Court the court of appeals' resolution of the issue presented to it on appeal. Rather, he limits his challenge to the resolution of the estate tax dispute to the contention that the "bona fide sale" exception should apply. Thus, petitioner contends that this Court should grant certiorari to decide the merits of a contention not considered by either court below and not even presented to the court of appeals until a motion to modify filed 75 days after the entry of the court's decision. There is no reason for this Court to depart from its usual course of proceedings and accede to such an extraordinary request.

To the extent that petitioner is asking this Court to review the procedural question whether the court of appeals should have granted the motion to clarify, his submission is also entirely without substance. The court of appeals was quite correct in denying petitioner's belated request to consider an argument that could and should have been raised in the regular course of proceedings. In any event, there is no merit to the new contention that petitioner belatedly seeks to raise. Thus, the court of appeals correctly held that part of the trust corpus is includable in the gross estate under Section 2036(a). Its decision does not conflict with any decision of this Court or of another court of appeals, and there is no reason for further review of the judgment below.

a. Petitioner does not dispute the court of appeals' conclusion that the decedent "made a transfer" within the meaning of Section 2036(a), which he acknowledges was the only issue considered by the courts below. Petitioner's sole contention on the merits (Pet. 6-12) is that the Court should grant review to consider another argument—namely, that this transfer falls within the statutory exception contained in Section 2036(a) for "a bona fide sale for an adequate and full consideration." Petitioner acknowledges that he did not raise this contention on appeal. Instead he brought this argument to the court of appeals' attention for the first time in a motion to modify the court's opinion and mandate, seeking to have the court of appeals declare this issue open for consideration in the first instance by the district court on remand.

It is well settled that, absent exceptional circumstances, this Court will not consider an argument that was not presented to or considered by the court of appeals. See, *e.g.*, *United States* v. *Lovasco*, 431 U.S. 783, 789 n.7 (1977); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970); *Duignan* v. *United States*, 274 U.S. 195, 200

(1927). Plainly, therefore, the Court will not grant certiorari when the primary question presented in the petition is one that was not presented to or considered by the court of appeals. Petitioner advances no exceptional circumstances that warrant a departure from this settled rule, and accordingly the petition should be denied for that reason alone.

b. Petitioner also appears to contend (Pet. 12-18) that this Court should grant certiorari to determine whether the court of appeals erred in denying the motion to modify its opinion. This contention is plainly without merit. First, the question whether a particular court of appeals opinion should be modified is not ordinarily one that has much significance beyond the particular case, and petitioner does not explain what broad legal issue is presented by this contention that warrants the attention of this Court. In any event, the court of appeals acted quite properly in denying the motion.

The issue before the district court was whether a portion of the trust corpus is includable in the gross estate of the decedent under Section 2036(a). Petitioner now states that there are two possible arguments on that score based on different parts of Section 2036(a). Petitioner could argue that the decedent did not "make a transfer" at all within the meaning of Section 2036(a) or, alternatively, that any transfer fell within the exception for a "bona fide sale." Petitioner is plainly mistaken in suggesting that, after the district court accepted the first argument and the government appealed, petitioner was not obligated to present the second argument to the court of appeals in order to preserve it.

The issue on appeal was the applicability of Section 2036(a), and it was incumbent upon petitioner to present the court of appeals with all of its arguments on that issue, including arguments that the district court did not need to

reach. There would have been nothing untoward in appellate consideration of such alternative arguments; as petitioner notes (Pet. 15 n.15), it is well settled that a party may present, and an appellate court may rely upon, an alternate ground for affirmance. What is inappropriate is for petitioner to assert that he has the right, in the name of "efficiency" (Pet. 17), to raise on separate appeals each of his arguments about the statute at issue, so long as the different arguments relate to different phrases in the statute. Petitioner was obligated to present to the court of appeals all of his arguments about the issue before the court, the applicability of Section 2036(a), and thus to give the court of appeals the opportunity to decide whether it wished to address all of those arguments or instead to remand the case for the district court to address some of them.

Thus, petitioner was clearly delinquent in not raising the "bona fide sale" argument before the court of appeals if he wished to preserve the issue. His motion to clarify was essentially equivalent to a petition for rehearing based upon a new argument (and an untimely petition, at that, since it was filed 75 days after the court of appeals' decision was entered). The court of appeals manifestly acted well within its discretion in declining to rehear the case, or to invite the district court to rehear it, based on this belated contention.

c. At all events, even if petitioner had preserved the "bona fide sale" argument on appeal, there would be no reason for this Court to grant certiorari to review that issue because petitioner's argument lacks merit. Petitioner maintains that, focusing "on the economic impact of the transaction as a whole" (Pet. 10), the decedent's estate was not depleted by the transaction and therefore any transfer to the trust must be regarded as a bona fide sale. Specifically, petitioner points to the fact that the decedent ended up with a life estate in the entire corpus of the trust.

Arguing that the value of a life estate in the 665 shares given by his father to the trust was greater than the value of the 85 shares that the decedent transferred to the trust, petitioner maintains that the transfer must be viewed as falling within the "bona fide sale" exception to Section 2036(a).

This analysis of the transactions forming the trust is untenable. The obvious purpose of the "bona fide sale" exception is to relieve from the estate tax those transfers in which the transferor receives an equivalent amount of consideration in exchange. See, *e.g.*, *Merrill* v. *Fahs*, 324 U.S. 308 (1945); *Estate of Frothingham* v. *Commissioner*, 60 T.C. 211, 214-216 (1973). For example, in *Estate of Davis* v. *Commissioner*, 440 F.2d 896 (3d Cir. 1971), upon which petitioner relies (Pet. 8-9), the decedent established a trust for his wife as part of a separation agreement. The court found that the transfer was "in consideration of [the wife's] relinquishing her right of support" (440 F.2d at 898 (internal quotation omitted)). Similarly, in several cases involving widow's elections in community property states (cited at Pet. 7-9), the courts have found that a portion of the transfer of the widow's share to a trust need not be included in her gross estate under Section 2036 because the transfer is made in consideration of the husband's making a similar transfer of his half of the community property.[3]

[3] See, *e.g.*, *Estate of Christ* v. *Commissioner*, 480 F.2d 171 (9th Cir. 1973); *United States* v. *Gordon*, 406 F.2d 332 (5th Cir. 1969); *Estate of Vardell* v. *Commissioner*, 307 F.2d 688 (5th Cir. 1962); *Gradow* v. *United States*, 11 Cl. Ct. 808 (1987). The widow's election basically involves a devise by one spouse of the entire community property to a trust for the lifetime benefit of the other spouse, subject to the proviso that the surviving spouse shall take nothing under the will unless she agrees to let her share of the community property also pass under the will (and hence to the trust). The spouse thus gives up her own share in the community property in accepting such a bequest of a life estate.

Whether or not the "widow's election" cases are correctly decided,[4] it is apparent that they lend no support to petitioner's argument here. The cases relied upon by petitioner are cases in which a property interest was found to have passed to the decedent as consideration for a transfer by him. Here, as both courts below recognized, it was agreed that the 665 shares in question passed from the decedent's father to the trust as a gift, and he paid gift tax upon that transfer. A donative transfer is, by definition, the opposite of a bargained-for exchange; plainly, a gift cannot be part of "a bona fide sale for an adequate and full consideration" within the meaning of Section 2036(a). Thus, petitioner is mistaken in asserting that the exception to Section 2036(a) applies whenever a decedent ends up better off after a series of transactions that include a transfer with reserved life estate. That is simply not the case if one of the transactions is a gift to him.[5]

The courts that have considered this question have recognized that the surviving spouse has "made a transfer" of her half of the property to the trust, with a reserved life estate. This transfer triggers the application of Section 2036(a), but the courts have also held that this transfer by the widow is in consideration of the husband's transfer to her of a life estate in his half of the property that is given to the trust. Accordingly, the courts have allowed her transfer to be offset by the consideration that she is deemed to have received.

[4] These decisions have been criticized as permitting avoidance of the estate tax in a situation that should be treated as a testamentary transfer. See Lowndes, *Consideration and the Federal Estate and Gift Taxes: Transfers for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts*, 35 Geo. Wash. L. Rev. 50, 65-84 (1966).

[5] Thus, petitioner's suggestion (Pet. 6) that the decision below creates a conflict in the circuits with the widow's election cases is clearly specious for two independent reasons – first, because the court of appeals did not consider or discuss petitioner's argument and, second, because even an explicit rejection of that argument would not conflict with any decision of another court of appeals.

The court of appeals decision that involves a situation most closely analogous to this one strongly counsels rejection of petitioner's argument. In *Giannini* v. *Commissioner*, 148 F.2d 285 (9th Cir.), cert. denied, 326 U.S. 730 (1945), each of three children held a life interest in a family trust. Each of the children had contributed 9.25% of the property in the trust, and their parents had made a gift of the balance. The court of appeals rejected the argument that the 9.25% interest transferred by one of the children was not includable, upon his death, in the gross estate under Section 2036(a), on the theory that the transfer was made in exchange for the parents' contribution to the trust and therefore qualified as a "bona fide sale." The court of appeals agreed with the estate that the decedent's total income interest in the trust was worth more than the 9.25% of the property that he himself had transferred, but the court ruled that the "bona fide sale" exception did not apply because the parents' transfer to the trust was a gift. The court explained (148 F.2d at 287): "The disproportionate value of the interest received resulted, however, not from bargaining but from the largess of the parents in donating a substantial sum for their children's financial security." Similarly here, any net benefit that the decedent derived from the transactions creating the trust resulted from his father's gift, not from a bona fide sale. See also *Mollenberg's Estate* v. *Commissioner*, 173 F.2d 698, 701 (2d Cir. 1949); *Phillips* v. *Gnichtel*, 27 F.2d 662, 665 (3d Cir. 1928); *Estate of Schwartz* v. *Commissioner*, 9 T.C. 229, 238 (1947).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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